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POPULIST RETRIBUTION AND INTERNATIONAL COMPETITION IN FINANCIAL SERVICES REGULATION

A.C. PRITCHARD[†]

The pattern of regulatory reform in financial services regulation follows a predictable pattern in democratic states.¹ A hyperactive market generates a bubble, the bubble deflates, and much financial pain ensues for those individuals who bought at the top of the market. The financial mess brings the scrutiny of politicians, who vow “Never again!” A political battle ensues, with representatives of the financial services industry fighting a rearguard action to preserve its prerogatives amidst cries for the bankers’ scalps. Regulations, carefully crafted to win the last war, are promulgated. Memories fade of the foolish enthusiasm that fed the last bubble. Slowly, greed once again comes to displace fear as the primary motivating influence in the marketplace. And as night follows day, another market run-up occurs, leading to a correction, and another round of calls for retribution against the greedy moneychangers who brought on the crisis.

This is a familiar story, not worth belaboring yet again, despite the opportunity afforded by the financial crisis ensuing from the collapse of the market for subprime mortgages. We had our latest bubble, followed by the market deflation, and the politicians are now responding to the calls for vengeance, and perhaps, reform. Instead of focusing narrowly on the latest iteration of this recurring pattern, in this Article I want to compare the political response to this iteration of financial meltdown with last century’s response to the stock market crash of October 1929 and the ensuing Great Depression. Comparing the two era’s responses affords an opportunity to explore the influence, if any, that international competition in financial services regulation might have on the political thirst for retribution. International competition in financial services was not much of a factor in the 1930s when Franklin Delano Roosevelt pursued his New Deal agenda; American capital markets were relatively independent of financial markets in the rest of the world. Today, however, international com-

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1. A useful history of the pattern can be found in STUART BANNER, *ANGLO-AMERICAN SECURITIES REGULATION* (Cambridge University Press, 1998).

petition has the potential to substantially constrain the regulatory decisions that Barack Obama's administration is currently contemplating.

The question: Does international competition limit the quest for political retribution? One hypothesis: competition among jurisdictions to attract financial services providers might limit the understandable urge to make the bankers pay for causing the financial crisis. Politicians may trip over each other as they rush to punish the money changers who caused the crisis, but do they want to kill the goose that lays the golden eggs? Exacting a pound of flesh may suit short-term political imperatives, but the financial services industry is an important source of tax revenues, and more importantly, campaign contributions for politicians. Sending the industry offshore would cut into a critical revenue source. And there is no shortage of jurisdictions what would welcome the money changers with open arms.

The alternative hypothesis, however, is that the populist anger – particularly when it is fueled by severe economic disruption in the real economy and high unemployment – simply dominates in the political economy of modern democracies. In that scenario, the short term benefits that accrue to political actors from appealing to popular anger over the financial crisis outweigh any potential long term benefits that those actors might reap from protecting the financial sector. Which force – competition or populism – is likely to prevail in the current fight to reform financial regulation? To give away the ending, my money is on populism, not competition. But there are limits to populism's force.

I. CHASING OUT THE MONEY CHANGERS: THEN AND NOW

There are many parallels between the financial crisis that the world faced in the 1930s and the one that we face today. The proximate cause of the Great Depression appeared to be the stock market collapse of 1929; today it is the collapse of the subprime market and the demise (or near demise) of a number of financial institutions that were too heavily exposed to that sector. The political response to these financial collapses was predictable. Roosevelt was elected with enormous popular support and a mandate to bring reform to a dysfunctional financial system that had brought the nation's real economy to its knees; Barack Obama was elected with a similar mandate. Roosevelt and Obama share liberal Democrat ideology, both are suspicious of unfettered free markets. Perhaps most importantly, Obama, like Roosevelt before him, enjoys the political advantage of strong Democratic majorities in both houses of Congress. On its face, this

electoral dominance suggests that the political wheel is well greased for success in enacting reform.

A. THEN: ROOSEVELT

Taming Wall Street was a key theme of Roosevelt's 1932 campaign. Roosevelt's central message was that capitalism failed because of the excesses of the capitalists. Roosevelt was quite comfortable casting the debate over reform as an "us versus them" question.² Roosevelt's detractors saw his agenda as thinly veiled class warfare. Roosevelt, however, did not flinch from the confrontation. He put the question in explicitly moral, and indeed vaguely religious terms, in his first inaugural address:

Practices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men.

* * *

Stripped of the lure of profit by which to induce our people to follow their false leadership, they have resorted to exhortations, pleading tearfully for restored conditions. They know only the rules of a generation of self-seekers.

They have no vision, and when there is no vision the people perish.

The money changers have fled their high seats in the temple of our civilization. We may now restore that temple to the ancient truths.³

In the popular mind, the bankers were responsible for the financial crisis. Roosevelt seized on that perception. Roosevelt showed an astute political sense by tapping into an incident in the life of Jesus that would have been quite familiar to the overwhelming majority of his constituents.⁴ Nonetheless, there is certain audacity to his rhetoric; it requires more than a little self-confidence to portray one's role as a politician as akin to that of Jesus.

Three-quarters of a century later, Barack Obama recalled Roosevelt's messianic invocation in his own call for financial reform. Here is Obama preaching to the money changers:

Unfortunately, there are some in the financial industry who are misreading this moment. Instead of learning the lessons of Lehman and the crisis from which we are still recovering, they are choosing to ignore them. They do so not just at their

2. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET 19-20* (3d ed., Apsen Publishers 2003).

3. President Franklin Delano Roosevelt, Inaugural Speech: (Mar. 4th, 1933), available at <http://www.hpol.org/fdr/inaug/>.

4. *Matthew* 21:12-17.

own peril, but at our nation's. So I want everybody here to hear my words: We will not go back to the days of reckless behavior and unchecked excess that was at the heart of this crisis, where too many were motivated only by the appetite for quick kills and bloated bonuses. Those on Wall Street cannot resume taking risks without regard for consequences, and expect that next time, American taxpayers will be there to break their fall.⁵

"[H]ear [Obama's] words," and stirring words they are, full of moralism condemning "the appetite for quick kills and bloated bonuses." The greed of the money-changers would not be allowed to imperil the nation again.⁶ Once again, "Never again!"

Roosevelt and Obama share an unfettered optimism in the ability of government to tame the forces of capitalism. In accepting the Democratic Party's nomination for President, Roosevelt promised wholesale reform of the securities and banking industries. After his inauguration, Roosevelt wasted no time in delivering on that promise. During his first term, Roosevelt pushed through Congress four pieces of legislation, dramatically re-engineering the financial services sector:

- The Securities Act of 1933⁷ ("Securities Act") brought the federal government into the regulation of the public offering of securities, curbing the investment bankers' prior domination of that process. The law required corporate issuers to make full disclosure when selling securities. The goal was to curb the speculative excesses of the 1920s.
- The Glass-Steagall Act of 1933⁸ ("Glass-Steagall"), which legally separated the businesses of commercial and investment banking. The law was intended to discourage deposit institutions from encouraging speculation in the stock market.
- The Securities Exchange Act of 1934⁹ ("Exchange Act") targeted the New York Stock Exchange, regulating trad-

5. President Barack Obama, Remarks by the President on Financial Rescue and Reform (Sept. 14, 2009), *available at* http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-Financial-Rescue-and-Reform-at-Federal-Hall. *Accord* Text of Obama's Speech on Financial Reform, N.Y. TIMES (Sept. 14, 2009), *available at* <http://www.nytimes.com/2009/09/15/business/15obamatext.html>.

6. The media seems to have caught on to the message. *See, e.g.*, Maureen Dowd, *Virtuous Bankers? Really!?!?*, N.Y. TIMES, Nov. 11, 2009, at A31, *available at* <http://www.nytimes.com/2009/11/11/opinion/11dowd.html> ("I think the bankers who took government money and then gave out obscene bonuses are the same self-interested sorts Jesus threw out of the temple.").

7. Securities Act of 1933, 15 U.S.C. §§77a-77aa (2006).

8. Glass-Steagall Act of 1933, ch. 89, 48 Stat. 162 (codified at 12 U.S.C. § 377).

9. 15 U.S.C. §§ 78a-78nn (2006).

ing practices and requiring disclosure of operations and results by companies listing on exchanges. The Exchange Act also created the Securities and Exchange Commission ("SEC") to administer the securities laws.

- The Public Utility Holding Company Act of 1935¹⁰ ("PUHCA"), which targeted the holding companies that owned most of the public utilities in the United States at the time. Easily the most contentious of the securities laws pushed by Roosevelt, PUHCA went well beyond disclosure that characterized the two earlier securities statutes and permitted the SEC to break up the pyramid structure of those holding companies and shape the corporate governance and capital structures of the reorganized firms. PUHCA's sweeping reforms would trigger a decade-long war in the courts, as the giant utilities resisted the efforts of the SEC to dismantle them.¹¹

How did Roosevelt overcome the lobbying efforts of the financial services industry to fend off his reform efforts? One factor paving the way for Roosevelt's reforms was that they tended to reduce competition in the regulated sectors, and thus increased the rents available to key market participants. The most obvious example is the Securities Act, which discouraged competition in securities underwriting. The Securities Act discouraged the sales tactics introduced by National City and other commercial banks, which had begun to compete with the traditional investment houses in the 1920s.¹² Glass-Steagall put up further barriers to competition by forcing banks to choose between commercial and investment banking. The net effect was to preserve pricing margins in underwriting, an effect which has persisted to this day. Similarly, the Exchange Act largely codified the disclosure requirements of the New York Stock Exchange, offering it protection against the laxer standards of the Curb Exchange, now known as the American Stock Exchange. The securities laws validated quality standards, but they did so by erecting barriers to entry.

Cartelization is always helpful in overcoming opposition to regulation, but perhaps more important were the hearings orchestrated by Ferdinand Pecora, chief counsel to the Senate.¹³ To call Pecora's staged events "hearings," which suggests an interest in uncovering facts, would be misleading. Pecora's "show trials" would be closer to

10. 15 U.S.C. §§ 79z-6 (2006).

11. The fight over PUHCA is chronicled in A.C. Pritchard & Robert B. Thompson, *Securities Law and the New Deal Justices*, 95 VA. L. REV. 841 (2009).

12. Paul G. Mahoney, *The Political Economy of the Securities Act of 1933*, 30 J. LEGAL STUD. 1 (2001).

13. SELIGMAN, *supra* note 2. Joel Seligman offers a complete account of the Pecora hearings and their influence on the course of legislation.

the mark; Pecora looked to score political points to underscore the need for legislation, not attempting to enhance the understanding of Congress. Pecora diligently sought out the evildoers in underwriting and stock trading, but he mainly succeeded in embarrassing prominent bankers like J.P. Morgan. Throughout the process, Pecora carefully courted media coverage, with marked success, regularly making front-page news.¹⁴ It is hard to imagine Pecora's show trials receiving the same sort of media attention today. One must take into account the media milieu of the era. Much less news was available at the time (no 24/7 coverage of Brad and Angelina!), so carefully orchestrated Congressional hearings had much greater impact then than they would now. Moreover, the Great Depression dragged on and on – with devastatingly high rates of unemployment and accompanying economic misery. Consequently, the anger at the bankers – popularly believed to have caused the Great Depression – was unabated.

Pecora tapped into that anger, making shrewd choices in bringing sunshine to perceived abuses. His preferred target: “excessive” compensation. In a nation beset by economic misery, envy was the key to enacting reform. As Joel Seligman writes:

The revelations of the Pecora hearings were intended to diminish . . . faith in the nation's financial institutions. No other explanation can account for the attention lavished by Pecora such matters as the salary levels and income tax returns of the financiers who appeared before him. Such data were virtually irrelevant to an investigation of the causes of the stock market crash. But in the political context in which the Senate Banking Committee functioned, such data seemed essential. In spite of the severity of the stock market crash, effective securities legislation might not have been enacted had Pecora's revelations not galvanized broad public support for direct federal regulation of the stock markets.¹⁵

Pecora uncovered the shocking revelation that the partners at the Morgan firm paid no taxes in 1931 and 1932, generating considerable press coverage. Less well covered by the papers, however, was the fact that the Morgan partners had not generated any *income* in those years, as their stock market losses in a free-falling market eclipsed any income that they might have eked out.¹⁶ No income, no income tax. Foreshadowing today's debates, Pecora also tried to pin the blame for financial recklessness on extravagant incentive compensa-

14. See Paul Mahoney, *The stock pools and the Securities Exchange Act*, 51 J. FIN. ECON. 343, 347 (1999).

15. SELIGMAN, *supra* note 2, at 2.

16. *Id.* at 33.

tion.¹⁷ The regulations that Congress ultimately enacted to check the financiers' compensation, however, focused on disclosure rather than directly limiting pay.¹⁸ The presumption was that shame would curb the bankers' appetite for exorbitant salaries. In hindsight, this seems naïve. As a group, bankers seem relatively immune to shame.

The bottom line for Roosevelt was that populist anger against the bankers provided him with the political capital he needed to fundamentally reshape the financial sector in the United States. Roosevelt succeeded in breaking up the commercial/investment banking giants, curtailing the most aggressive selling tactics of the securities underwriters, and putting the New York Stock Exchange and its broker-dealer members under the watchful eye of the newly-created SEC. Roosevelt won a great political victory against the capitalists, but he did so in a world in which capital markets were generally fragmented on a country-specific basis. Is Barack Obama likely to have the same success in reshaping finance in a world of integrated capital markets?

B. NOW: OBAMA

Simply based on the sheer number of proposals made, Obama's vision of regulatory reform equals Roosevelt's in its ambition.¹⁹ But once one delves into the details, some aspects of the plan look rather timid. Raising capital requirements was a given of any reform.²⁰ But imposing more stringent capital requirements on the largest banks provides an implicit list – and accompanying subsidy – of the institutions that the government deemed “too big to fail.” The moral hazard problem created by “too big to fail” is the central problem of reform. Obama's plan addresses that problem with a conservatorship provision that would wipe out equity holders.²¹ The administration tacitly rejected reform proposals to directly reduce the size of banks, as some – like Alan Greenspan – have urged.²² This exposed Obama's left

17. *Id.* at 26.

18. See generally Harwell Wells, “No Man can be worth \$1,000,000 a year”: *The Fight Over Executive Compensation in 1930s America*, 44 U. RICH. L. REV. ____ (forthcoming, 2010).

19. For a useful synopsis, see Washington Wire, *Obama's Financial Reform Plan: The Condensed Version*, WALL ST. J., June 17, 2009, available at <http://blogs.wsj.com/washwire/2009/06/17/obamas-financial-reform-plan-the-condensed-version/tab/article/>.

20. Stephen Labaton, N.Y. TIMES, DealBook, *Treasury Unveils Proposal for New Bank Capital Rules*, , available at <http://dealbook.blogs.nytimes.com/2009/09/03/treasury-unveils-proposal-for-new-bank-capital-rules/> (Sept. 3, 2009, 18:33).

21. Stephen Labaton, *Bill Seeks to Shift Rescue Costs to Big Banks*, N.Y. TIMES, Oct. 28, 2009, at B1, available at <http://www.nytimes.com/2009/10/28/us/politics/28regulate.html>.

22. Michael McKee & Scott Lanman, *Greenspan Says U.S. Should Consider Breaking Up Large Banks*, BLOOMBERG, Oct. 15, 2009, available at <http://www.bloomberg.com/apps/news?pid=20601087&sid=aJ8HPmNUfchg>; David Wessel, *Three Theories on Solv-*

flank, as some lawmakers pursued legislation that would break up the banks, either based on size, or by restoring the Glass-Steagall limits that precluded the combination of investment and commercial banking.²³

Notably absent from Obama's proposal is any consolidation of agencies. There is some shuffling of agencies, with a new National Bank Supervisor to be created, while the Office of Thrift Supervision is to get the axe. But the alphabet soup of banking regulators continues, albeit with augmented powers. The long-standing jurisdictional overlap between the SEC and Commodity Futures Trading Commission ("CFTC") is not eliminated by combining the agencies; instead, Obama's administration has instructed the agencies to play nice through greater harmonization. Charged with a wholesale overhaul of the regulatory system, the administration appears to have sought the path of least resistance in carrying out that mandate, at least when it comes to dealing with entrenched bureaucracies – and the Congressional patrons who love them.

When it comes to vesting those agencies with new mandates and new authority, however, Obama is anything but cautious. Most telling is the extension of government authority into previously unregulated territory. The Obama administration's plan greatly expands the powers for the Federal Reserve, setting it up as an "uber-regulator" charged with controlling systemic risk. A new Consumer Financial Protection Agency would be created to protect consumers by overseeing credit cards and mortgages. Over-the-counter derivatives would be forced on exchange, and therefore, into the regulated sphere. Hedge funds, private equity funds, and venture capital firms would be required to register with the SEC, with hedge funds subject to particular scrutiny.²⁴

This last set of proposals is particularly puzzling. No one has seriously suggested that hedge funds, private equity, or venture capitalists played any role in causing the financial crisis. If anything, hedge funds are useful antidote to a bubble mentality. Private equity and venture capitalists are essentially irrelevant to that problem; they op-

ing the 'Too Big to Fail' Problem, WALL ST. J. A2 (Oct. 28, 2009), available at <http://online.wsj.com/article/SB125668497563411667.html>.

23. Damian Paletta & Michael R. Crittenden, *Curbing Size of Big Firms*, WALL ST. J., Nov. 10, 2009, at A5, available at <http://online.wsj.com/article/SB125781175800739933.html> (discussing bills in House); N.Y. TIMES, Dealbook, *Senator Seeks to Break Up Banks 'Too Big to Fail,'* (Nov. 6, 2009), available at <http://dealbook.blogs.nytimes.com/2009/11/06/senator-seeks-to-break-up-banks-too-big-to-fail/> (discussing billed introduced by Senator Bernard Sanders to break up large banks).

24. Kevin Drawbaugh & Rachelle Younglai, *Congressional Panel Backs New Rules for Hedge Funds*, REUTERS, October 27, 2009, available at <http://www.reuters.com/article/idUSTRE59Q5BY20091027>.

erate in a totally different sphere. So why add more regulation to one of the few bright spots in the financial services industry? As Rahm Emanuel noted shortly after Obama's election, "You never want a serious crisis to go to waste."²⁵ Hedge fund managers are (at least some of them) incredibly wealthy people. These are people well-positioned to make political contributions to head off draconian regulation.²⁶ Given the inevitability of compromise, however, draconian regulation is never the first step. The first step is registration, and a bit of disclosure. Once that beachhead has been secured, truly invasive regulation becomes a credible threat in the wake of the next scandal. That credible regulatory threat is essential to the ability of politicians to extract contributions from the regulated industry.²⁷ Contribute, or we'll regulate! Regulation – or more accurately, the political class that feeds off it – abhors a vacuum.

Another objection that might be raised to the overall expansion of government power is that for every failed market institution in the late crisis, one can also point a finger at a corresponding failed regulatory institution.²⁸ American International Group ("AIG") imploded as a consequence of lax risk management? The Office of Thrift Supervision had jurisdiction, but failed to exercise it. Turning to the big investment banks, Lehman, Bear Stearns, and Merrill Lynch all over-extended themselves? The SEC oversaw their capital requirements (or lack thereof). Credit rating agencies failed to predict the meltdown of the market for mortgage-backed securities? The SEC had recently been given greater regulatory authority over the industry. Mortgages extended to borrowers with little hope of repaying? Freddie Mac and Fannie Mae were there to guarantee the loans, backed by an implicit government backstop.

Roosevelt had the advantage of being able to point the finger exclusively at the financiers. If there was a regulatory failure, it was at the state level. The states' failure to adequately grapple with the problems merely reinforced the need for federal intervention. Roosevelt plowed virgin regulatory ground for the federal government.

25. Jack Rosenthal, *On Language: A Terrible Thing to Waste*, N.Y. TIMES July 31, 2009, available at <http://www.nytimes.com/2009/08/02/magazine/02FOB-onlanguage-t.html>.

26. Hedge funds were good for some \$60 million in contributions in 2008. Center for Responsive Politics, *Hedge Funds: Money to Congress*, <http://www.opensecrets.org/industries/summary.php?cycle=2008&ind.=f2700>. They have been gearing up to try and ward off the regulatory onslaught. Zachery Kouwe, *Funds Try to Ward Off New Regulations*, N.Y. TIMES, Oct. 1, 2009, available at <http://dealbook.blogs.nytimes.com/2009/10/01/funds-try-to-ward-off-new-regulations/>.

27. FRED S. MCCHESENEY, *MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION* (Harvard Univ. Press, 1997).

28. Gretchen Morgenson, *But Who Is Watching the Regulators?*, N.Y. TIMES, Sept. 13, 2009, at BU1.

Obama, by contrast, is stuck with a singularly awkward fact: the regulatory failure of the mortgage crisis was at the hands of the regulators who are now to be charged with preventing the recurrence of the crisis. This is less than satisfying for voters keen on retribution. Political morality plays are more compelling when there is a clean division between the white hats and the black hats.

Obama's ambitious agenda met with widespread acclaim when it was announced, but it has since run into some strong headwinds.²⁹ The government's first high profile criminal case arising out of the subprime meltdown was rebuffed by the jury.³⁰ The government's high profile effort at scapegoating fell short: "The entire market crashed," one juror explained. "You can't blame that on two people."³¹

But you can try to pin it on an entire class: the bankers. Astonishingly, the bankers appear reluctant to shoulder the blame. The inevitable regrouping of the banking industry and its lobbying efforts is posing more of a challenge for Obama's reform efforts. Obama does not have a Pecora to keep the drumbeat for reform going.³² As Treasury Secretary Timothy Geithner observed, "Time is the enemy of reform."³³ This is particularly true when time is accompanied by signs of economic recovery.³⁴ Roosevelt had the advantage (!?) of ongoing economic misery; the thirst for vengeance against the financial plutocrats went unabated well into the mid-1930s. Today, the stock market has shown signs of renewed vigor. The banks have begun to return to profitability, perhaps bolstered by the cheap financing provided by the government. When the banks depended upon the largesse of the federal government, they were on the mat as a political force. As the banks have paid back the bailout money, however, they lost their com-

29. Elizabeth Williamson and Damian Paletta, *Obama Urges Bankers to Back Financial Overhaul*, WALL ST. J., Sept. 15, 2009, at A4. ("[Obama]'s proposed changes to financial rules have bogged down in part because of backlash from banks and conservative lawmakers.").

30. Amir Efrati & Peter Lattman, *U.S. Loses Bear Fraud Case*, WALL ST. J., Nov. 11, 2009, at A1.

31. William D. Cohan, *How the Scapegoats Escaped*, N.Y. TIMES, Nov. 12, 2009, A35.

32. Congress has created a commission to examine the causes of the financial crisis, but is a pale imitation of Pecora's efforts. Critically, it is not scheduled to complete its report until the end of 2010, well after the debate over regulatory reform will have finished. See Stephen Labaton, *A Panel Is Named to Examine Causes of the Economic Crisis*, N.Y. TIMES, July 16, 2009, at B3.

33. Robert Schmidt, *Geithner Says 'Time Is the Enemy' of Financial Rules Overhaul*, BLOOMBERG, Sept. 23, 2009, available at <http://www.bloomberg.com/apps/news?pid=20601103&sid=a0rFGAlzzTQE>

34. Associated Press, *Urgency For New Rules For Finance Is Slipping Away* (Sept. 16, 2009).

punction about lobbying against regulatory reform.³⁵ (This only angers the electorate more; the bankers should submit and take their punishment.) Threats to break up large banks galvanized Wall Street lobbyists into action,³⁶ and Congressmen have campaigns to finance in 2010. It is never too soon to start extracting campaign contributions from a regulated industry; a crisis is a terrible thing to waste – it is a fundraising opportunity of a political lifetime!

Bickering also broke out among regulators about the regulatory functions to be shifted about,³⁷ provoking a testy response from Treasury Secretary Timothy Geithner.³⁸ Most surprising perhaps has been the reaction of the Senate to the failure to consolidate any of the banking agencies. Although the House of Representatives went along with the blueprint provided by the Obama administration, the Senate Finance Committee broke ranks, sending out a bill that would consolidate banking supervision in a single regulator.

The Senate bill would also remove substantial oversight authority from the Federal Reserve (the “Fed”).³⁹ Critics of Obama’s plan warned that giving the Fed more authority would undermine its independence.⁴⁰ Heeding their concerns was Senator Christopher Dodd, Chair of the Senate Banking Committee, who apparently considered the Obama plan insufficient on retribution against the failed regulators. After all, Dodd was running for re-election, and “Even if his regulatory-overhaul plan runs aground, it could help Mr. Dodd position himself as a populist lawmaker willing to wage war on powerful financial institutions.”⁴¹ A willingness to wage war is the critical factor in regulatory reform – at least as far as the voters are concerned. Of

35. Stephen Labaton, *Lobbyists Mass to Try to Shape Financial Reform*, N.Y. TIMES, Oct. 15, 2009, available at <http://www.nytimes.com/2009/10/15/business/15regulate.html>; Graham Bowley, *Two Giants Emerge From Wall Street Ruins*, N.Y. TIMES, July 17, 2009, at A1.

36. *Bank Breakup Plan, Still Unseen, Draws Wall St. Ire*, <http://dealbook.blogs.nytimes.com/2009/11/12/bank-breakup-plan-still-unseen-draws-wall-st-ire/> (Nov. 12, 2009, 18:21).

37. Stephen Labaton, *F.D.I.C. Chiefs Criticizes Reform Plan*, N.Y. TIMES, Oct. 30, 2009, B1, available at <http://www.nytimes.com/2009/10/30/business/30regulate.html>; Richard Beales, *Battle is Brewing Over Watchdogs*, N.Y. TIMES, June 22, 2009, B2, available at <http://www.nytimes.com/2009/06/22/business/22views.html>.

38. Stephen Labaton, *Geithner Takes Regulators to Task on Turf Battle*, N.Y. TIMES, Aug. 6, 2009, B1, available at <http://www.nytimes.com/2009/08/06/us/politics/06regulate.html> (“One participant in the meeting said the bank regulators felt that Mr. Geithner treated them like children being reprimanded by a parent.”).

39. Stephen Labaton, *Senate Plan Would Expand Regulation of Risky Lending*, N.Y. TIMES, Nov. 11, 2009, at B1, available at <http://www.nytimes.com/2009/11/11/business/11regulate.html>.

40. Edmund L. Andrews, *Two Authorities on Fed Advise Congress Against Expanding Its Power*, N.Y. TIMES, July 10, 2009, at B3, available at <http://www.nytimes.com/2009/07/10/business/economy/10fed.html>.

41. Damian Paletta, *Clash Looms on Banks*, WALL ST. J., Nov. 5, 2009, at A1, A6.

course, as independent agencies go, the Fed comes closest to actual independence from Congress, unlike the banking agencies, SEC, and CFTC, which are quite vulnerable to Congressional manipulation.⁴² The Fed, not surprisingly, was of the view that its mission made it critical that it retain supervisory authority over banks.⁴³ Girding for the fight, Fed Chairman Ben Bernanke brushed up on how to deal with Congress.⁴⁴

Amidst all the squabbling inside the Beltway, where is there still some semblance of consensus? The insidious evil of incentive compensation. When it comes to pay issues, the populism that helped fuel Roosevelt's successful drive for reform is again on abundant display. Sometimes that display is rather embarrassing, such as Senator Charles Grassley's call for ritual suicide by executives at AIG who received retention bonuses after the United States government bailed the company out. Never mind that the AIG executives receiving bonuses were not the ones responsible for its losses, or that losses would have been much worse if they left the firm.⁴⁵ Also ignore the fact that AIG is losing key employees to competitors.⁴⁶ These are details.

Grassley is just the most extreme example of politicians fulminating over excessive executive pay in the financial services sector. Political actors with actual responsibilities also stepped in to crack down on pay. Andrew Cuomo, the New York State Attorney General, burnished his credentials for governor by bullying AIG executives into paying back a portion of those ill-gotten bonuses that so enraged Grassley.⁴⁷ Cuomo also launched an assault on another front against bankers' bonuses by launching an investigation of Merrill Lynch

42. See A.C. Pritchard, *The SEC at 70: Time for Retirement?* 80 NOTRE DAME L. REV. 1073 (2005) (discussing Congress's control over the SEC and its impact on securities regulation). Dodd's plan is notable in that it would free the SEC from dependence on Congress for funding, allowing the agency to keep the levies it imposes on stock trading. Labaton, *supra* note 39. The chances of this provision surviving in the final bill strike me as remote.

43. Paletta, *supra* note 41.

44. Edmund L. Andrews, *Under Attack, Fed Chief Studies Politics*, NY TIMES, Nov. 11, 2009, at A1.

45. Letter from Jake DeSantis, Executive Vice President, AIG to Edward M. Liddy, CEO, AIG, New York Times (March 25, 2009) (available at <http://www.nytimes.com/2009/03/25/opinion/25desantis.html>). Shockingly, the political backlash pushed a number of the AIG managers out the door, increasing the cost of unwinding the losing positions. Liam Plevin & Randall Smith, *Action on AIG Unit May Cost Taxpayers*, WALL ST. J., Apr. 13, 2009, at C1.

46. Mary Williams Walsh, *Ex-A.I.G. Chief Is Back, Luring Talent From Rescued Firm*, NY TIMES, Oct. 27, 2009, at A1.

47. *A.I.G. Memo Hints at Pressure From Cuomo*, <http://dealbook.blogs.nytimes.com/2009/03/24/aig-memo-points-to-pressure-from-cuomo/> (March 24, 2009, 15:05).

before that firm merged with Bank of America.⁴⁸ Cuomo needs to be careful:

[T]here is a division among state officials over how vigorously New York's attorney general should batter Wall Street. On the one hand, there has been outrage across the country at the enormous bill for the rescue of Wall Street, even as tales of greed, excess and Ponzi schemes have proliferated. On the other hand, New York depends on Wall Street for about a fifth of the state's revenue, and its latest troubles have depleted the state's coffers.⁴⁹

If Cuomo pushes too hard, that golden goose could quickly cross the river to New Jersey.

Politicians at the federal level may have more room to maneuver in assuaging the popular outrage. The Obama administration, not wanting to be outflanked by state regulators, appointed a "pay czar," Kenneth Feinberg, charged with overseeing compensation at firms receiving bailout funds. Feinberg made headlines above the fold when he ordered sweeping pay cuts at those firms.⁵⁰ The paycuts came amidst huge departures of top talent at those firms.⁵¹ Certain profitable divisions – with exorbitant pay for their traders – had to be sold off rather than face the scrutiny of the pay czar.⁵² Despite the fact that the profitability of the bailed out firms was key to the government being repaid, anger at pay levels trumped worry over bailout funds being dissipated. A more widespread, if less draconian, initiative came from the Fed. The Fed is considering a plan to review banks' compensation schemes to ferret out excessive risk taking.⁵³ The Senate bill also attempts to crack down on compensation that engenders

48. Letter from Andrew M. Cuomo, New York Atty. Gen'l to Honorable Barney Frank, Chairman, House Committee on Financial Services (February 10, 2009), available at http://www.ag.ny.gov/media_center/2009/feb/merrill%20letter.pdf, (describing Cuomo's investigation into payment of bonuses at Merrill Lynch after government sponsored merger with Bank of America).

49. Danny Hakim, *Not Running Against Wall St.*, N.Y. TIMES, Oct. 29, 2009, at B1.

50. Deborah Solomon & Dan Fitzpatrick, *Pay Slashed at Bailout Firms*, WALL ST. J., Oct. 22, 2009, at A1.

51. Louise Story, *Who Gets Paid What*, N.Y. TIMES, Oct. 22, 2009, at B1. "When Bank of America submitted the names of top executives to Mr. Feinberg, its representatives pointed out that 45 of the top 100 employees at the bank and Merrill had left." *Id.* Feinberg appears to be open to paying their replacements market rates. David Lawder, *Obama Pay Czar Says Open to Competitive Pay Offers*, REUTERS, Nov. 12, 2009, <http://www.reuters.com/article/idUSTRE5AB2RF20091112>. This invites the question of whether it would be simpler to retain the existing employees by paying them market rates, does it not?

52. Louise Story, *Pay Czar Doubts Cuts Will Make Bankers Leave*, N.Y. TIMES, Oct. 23, 2009, at B8. (detailing sale of Citigroup's Philbro unit).

53. Damian Paletta & Jon Hilsenrath, *Bankers Face Sweeping Curbs on Pay*, WALL ST. J., Sept. 18, 2009, at A1.

an undefined level of “excessive risk.” Excessive risk? They will know it when they see it. They are experts after all.

Widely ignored in this flurry to crack down on the pay of financial executives is the fact that those executives have lost millions of dollars in worth as their stock portfolios shriveled. Bank shareholders have been hit hard, but the managers of those firms, underdiversified with respect to exposure to their employers’ stock, have been hit much harder. They can still afford the private school tuition for the kids, but it does not require much empathy to see that they have shared their shareholders’ pain.⁵⁴ This is not a distributive justice point; it is a simple matter of risk management policy. Inflicting more pain on bank executives may help assuage the popular anger, but it is unlikely to make those executives more sensitive to the consequences of their decisions. The more likely response to the crackdown on pay is to head for the door. The question is: Where will they head? And will the exodus be only individual executives, or will firms be leaving as well?

II. FINANCIAL CRISES: THE NEW WORLD ORDER

Obama faces one obstacle in 2009 that Roosevelt did not need to worry about in 1933: a radically transformed financial sector that now transcends national boundaries. Companies can raise financing in markets around the world as capital now flows as freely as other goods and services.⁵⁵ Jurisdictional competition spread from corporate law to its close cousin, securities law. Historically, issuers listed their stock for trading on one of the exchanges in the country where they principally did business. Improvements in communication and related technologies, however, have made possible an *international* market for stock exchange listings that resembles in many respects the long-standing *federal* market for corporate charters in the United States. Now companies can list their shares for trading on exchanges in any number of countries; there is no longer a logical nexus between the site of a company’s headquarters and where its shares are traded. Chinese companies, for example, are listed in Shanghai and Hong Kong, but also in New York. Investors can realistically allocate their savings to companies around the world. Our world today – unlike the world of the 1930s – is marked by free trade in capital. Does that free movement of capital limit the ability of the Obama administration to reform financial regulation in the United States?

54. David Yermack, *Keeping the Pay Police At Bay*, WALL ST. J., Oct. 10, 2009, at W1.

55. My argument here borrows from, and expands upon, my earlier article, A.C. Pritchard, *London as Delaware?*, 78 U. CIN. L. REV. ____ (forthcoming, 2010).

New York's principal rival for the status of the world's leading financial center is London. After the United States effectively raised listing standards by enacting the Sarbanes-Oxley Act⁵⁶ in 2002, foreign companies headed for the door.⁵⁷ London seized the opportunity; fourteen of the top twenty initial public offerings ("IPOs") listed on the London Stock Exchange ("LSE") came from outside the United Kingdom in 2005 to 2008. By contrast, only four of the top twenty IPOs in New York came from outside the United States.⁵⁸ Further, it was not only foreign companies that were leaving; United States companies left the public market in droves, headed for the greener (or at less regulated) fields of private equity, and they were not being replaced. A Grant Thornton study documented a staggering thirty-nine percent decline in United States listings from a peak of 8,823 in 1997 to only 5,401 in 2008.⁵⁹

While New York hemorrhaged listings, London's pool of liquidity grew deeper, as it developed its own community of hedge funds and private equity. The United Kingdom is heavily dependent on financial services, with the financial services industry growing from 5.3 percent of the economy in 2001 to 9.4 percent in 2006,⁶⁰ and employing a half-million people in London alone.⁶¹ Moreover, the United Kingdom's Financial Services Authority's ("FSA") "light touch" approach to regulation gives London a predictability edge over New York, which is subject to the much more intrusive (and expensive) scrutiny of the SEC.⁶² London's unitary financial services regulator also reduces

56. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

57. Committee on Capital Markets Regulation, Summary of Competitiveness Measures (2008) (noting that 15% of foreign firms listed on the NYSE delisted in 2007). See also Craig Doidge, G. Andrew Karolyi, & Rene M. Stulz, *Why Do Foreign Firms Leave U.S. Equity Markets?*, (DICE Center Working Paper No. 2009-3, 2009) (finding that departing firms had lower growth prospects and capital requirements).

58. REVIEW OF THE COMPETITIVENESS OF LONDON'S FINANCIAL CENTRE, LONDON: WINNING IN A CHANGING WORLD (2008), available at <http://www.london.gov.uk/mayor/economy/docs/london-winning-changing-world.pdf>. (Page 13, Exhibit 3). See also Joseph D. Piotroski & Suraj Srivivasn, *Regulation & Bonding: The Sarbanes-Oxley Act and the Flow of International Listings* (Rock Center for Corporate Governance at Stanford University Working Paper No. 11) (2008), available at <http://ssrn.com/abstract=956987>. (finding a shift in smaller firm listings post-Sarbanes-Oxley).

59. Lynn Cowan, *Stock Study Laments the 'Great Depression of Listings'*, WALL ST. J., Nov. 10, 2009, at M4.

60. REVIEW OF THE COMPETITIVENESS OF LONDON'S FINANCIAL CENTRE, LONDON: WINNING IN A CHANGING WORLD (2008), available at <http://www.london.gov.uk/mayor/economy/docs/london-winning-changing-world.pdf>. (Page 13, Exhibit 4).

61. REVIEW OF THE COMPETITIVENESS OF LONDON'S FINANCIAL CENTRE, LONDON: WINNING IN A CHANGING WORLD (2008), available at <http://www.london.gov.uk/mayor/economy/docs/london-winning-changing-world.pdf>. (Page 14, Exhibit 5).

62. SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP (2007), available at http://www.abanet.org/buslaw/committees/CL116000pub/materials/library/NY_Schumer-Bloomberg_REPORT_FINAL.pdf. (Page 77, reporting survey results of senior executives indicating greater perceived predictability of legal regime in

compliance costs in the United Kingdom relative to those imposed by the splintered regulatory structure found in the United States, with its alphabet soup of federal and state agencies, regulating broker-dealers, banks, and insurers. Will London take advantage of the populist onslaught on New York?

The early returns suggest no; British politicians and regulators are happy to join in the feeding frenzy. British banks melted down in lockstep with those in the United States.⁶³ The rhetoric now emanating from London is strongly suggestive that populist retribution has taken hold in the United Kingdom just as it has in the United States. A conspicuous example is Adair Turner, head of the FSA. One would not have suspected Turner of being a closet foe of capitalism; he was the Former Vice-Chair of Merrill Lynch Europe. However, his current language sounds very much like Louis Brandeis's warnings about the curse of bigness.⁶⁴ In a recent speech, Turner called for a radical reduction in the size of the financial services sector in the United Kingdom. Turner worried that "some of it is socially useless activity," and that the sector has "swollen beyond its socially useful size."⁶⁵ Turner struck at the heart of the financial services industry by suggesting the adoption of a tax on securities transactions, a so-called Tobin tax.⁶⁶ He warned that regulators should not be involved in promoting the competitiveness of the British financial services industry: "It's clear to me that the FSA has to be very, very wary of seeing the competitiveness of London as a major aim."⁶⁷ Turner's suggestions may or may not be sensible policy; they are clearly inimical to the goal of the United Kingdom's competitiveness as a financial center. Turner is not concerned.

Turner's chief lieutenant, Hector Sants, sounded positively Obama-esque in chiding the bankers: "There remains, I believe, an absence of the acceptance of collective responsibility for what has hap-

the U.K.). The U.K.'s "light touch" approach should not be confused with a "laissez faire" attitude. See Eilís Ferran, *Capital Market Competitiveness and Enforcement* (University of Cambridge Working Paper, at 6, 2008) (discussing recent enforcement actions brought by the FSA).

63. Jon Menon & Andrew MacAskill, *U.K. Faced 'Bank Runs, Riots' as RBS and HBOS Nearing Collapse*, BLOOMBERG, Oct. 6, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aMfETcYI2t7Y>.

64. LOUIS D. BRANDEIS, *THE CURSE OF BIGNESS: MISCELLANEOUS PAPERS OF LOUIS D. BRANDEIS* (Osmond K. Fraenkel and Clarence M. Lewis, eds., The Viking Press 1934).

65. Patrick Hosking, *FSA chairman Lord Turner says City too big*, THE TIMES (Aug. 27, 2009).

66. Landon Thomas, Jr., *Britain's Top Financial Regulator Takes On Banks*, N.Y. TIMES, Sept. 24, 2009, at B1.

67. Hosking, *supra* note 65.

pened.”⁶⁸ It is not at all clear what the “acceptance of collective responsibility” would look like, or how it would change anything. Sants earlier warned that the bankers to blame for the crisis should be “very frightened” of the FSA; more ominously, he declared that “a principles-based approach does not work with individuals who have no principles.”⁶⁹ Sants, like Turner, is not worried about maintaining British competitiveness in financial services. Sants may have been burnishing his credentials in an effort to retain an important regulatory role. The Conservative Party, likely to reclaim power in the United Kingdom’s next elections, pledged to strip the FSA’s regulatory authority over banks and give it to the Bank of England (“BOE”).⁷⁰ Sants is rumored to be in line for a position at the BOE in a Tory government.⁷¹ The BOE took a hawkish line toward the banks. Notably, the head of the BOE, Mervyn King, called for the breakup of the big banks.⁷² King appeared to go out of his way to outflank the FSA; the FSA’s efforts amounted to “little real reform,” according to King.⁷³

The Labour Party took up the call as well. The Chancellor of the Exchequer, Alistair Darling, picked up on the moral outrage. “The whole world is angry about it but they just don’t get it,” he said as he decried the level of pay packages now being discussed. “There are far too many people in the banking world who haven’t caught the change in sentiment.”⁷⁴ Darling is angry, not only at the bankers but also with the banks’ shareholders. “Their shareholders clearly didn’t ask the right questions. They didn’t take their stewardship seriously.”⁷⁵ The notion of “stewardship” is generally not associated with shareholders, who are generally viewed as passive renters of capital, but the obvious problems of collective action and rational apathy apparently cannot stand in the way of widespread outrage. In another sign that the Labour politicians are desperate to retain their jobs, Prime Minister Gordon Brown recently endorsed Turner’s idea of a transaction tax at a recent meeting of the G-20, only to be rebuffed by Trea-

68. Juli Werdigier, *Financial Regulations Chief Chides British Banks*, N.Y. TIMES, Nov. 10, 2009, at B12.

69. FSA to ‘frighten’ with tough stance, FINANCIAL TIMES, http://www.ft.com/cms/s/0/2dbf2b7e-0ef8-11de-ba10-0000779fd2ac,s01=1.html?ftcamp=rss&nclck_check=1 (March 13, 2009, 00:15).

70. Laurence Norman & Alistair MacDonald, *Tories Ready a Plan to Bulk Up BOE*, WALL ST. J., Sept. 14, 2009, at C5.

71. *Conservatives Want Sants as Bank Deputy*, REUTERS, Nov. 13, 2009, <http://uk.reuters.com/article/idUKTRE5AC1A320091113>.

72. Natasha Brereton & Stephen Fidler, *BOE’s King: Big Banks Should Get Broken Up*, WALL ST. J., Oct. 21, 2009, at C1.

73. *Id.* at C2.

74. Patience Wheatcroft, *U.K.’s Darling Blasts Banks’ Investors*, WALL ST. J., Nov. 13, 2009, at C2.

75. *Id.*

surey Secretary Geithner.⁷⁶ British regulators appear to be trying to outdo each other in getting tough on the banks; they are clearly prepared to administer more retribution than the Americans, competitiveness be damned.

The United Kingdom's regulatory crackdown is taking place against the backdrop of threatened regulation by the European Union ("EU"). Involving the EU, however, creates plenty of room for disagreement. For example, France and Germany are less keen on bolstering capital requirements because it would require their banks to catch up with better capitalized American banks. This is an important political issue in those countries, as French and German companies are considerably more dependent on bank financing.⁷⁷ Bolstering capital requirements would necessarily come at the expense of lending, and hence, economic growth. The United States papered over the quarrel with the continental nations with the classic evasion of putting off the question of specific ratios until the end of 2010.⁷⁸ Perhaps there will be a stronger economic recovery by then, bolstering the tolerance of European politicians for more stringent capital requirements. Or perhaps stronger economic recovery will diminish the recollection of the pain of the downturn and bolster the bankers' ability to resist more stringent capital requirements. But specificity of capital ratios cannot be avoided forever if capital requirements are to have any teeth.

When it comes to banker pay, however, Europe is in accord. "Europe is united on a strong political message," said French President Nicolas Sarkozy, an enthusiastic proponent of caps on compensation.⁷⁹ France already imposed its own limits; having done so, it will want to level the playing field so that banks headquartered in other countries are subject to the same constraints.⁸⁰ Of course, the financial sector is much smaller in France than in Britain; political posturing poses minimal risk of capital flight. Further, the French – inventors of the guillotine – understand populist retribution better than anyone!

When it comes to banker pay issues, jurisdictional competition seems to be a nonfactor. Even Switzerland and Hong Kong – not

76. Laurence Norman & Paul Hannon, *U.S., U.K. Split Over Bank-Tax Proposal at G-20*, WALL ST. J., Nov. 9, 2009, at A12.

77. Damian Paletta & Alessandra Galloni, *Europe, U.S. Spar On Cure For Banks*, WALL ST. J. A1 (Sept. 23, 2009).

78. Edmund L. Andrews, *U.S. Hopes for Global Accord on Financial Reforms*, N.Y. TIMES, Sept. 23, 2009, at B5.

79. Stephen Castle, *Banker Pay to Face Global Limits at G-20 Session*, NY TIMES, Sept. 18, 2009, at B6.

80. Gabriele Parussini & Laurence Norman, *France Lunges for Bankers' Pay*, WALL ST. J., Nov. 6, 2009, at A3.

places that one would ordinarily associate with stringent limits on banks – stepped up with their own proposals to limit bankers' pay.⁸¹ On this issue in financial reform, there seems to be an emerging consensus – bankers' paychecks are going to be closely tied to the long-term performance of their employers.

Politicians also agree on the desirability of regulating hedge funds, but here jurisdictional competition is likely to have a greater impact. Unlike the banks, which require the backing of a lender of last resort and the implicit protection of the "too big to fail" doctrine, hedge funds can go elsewhere if a country tries to enmesh them in red tape. Running a hedge fund only requires an office and an Internet connection. To be sure, the speed of that Internet connection may be a constraint under current technology – quantitative traders want immediacy – but it is difficult to see that being an obstacle to hedge fund mobility in the long run. Debates over hedge fund regulation take place against the shadow of the threat of the flight of these financial intermediaries.

And that flight has already begun. The United Kingdom raised its top tax rate to fifty percent in April. That move, along with EU restrictions on borrowing by hedge funds, already prompted a number of hedge funds to emigrate to greener pastures.⁸² The exodus is likely to turn into a flood if EU regulations limiting hedge fund pay are implemented; the EU proposed requiring that up to sixty percent of hedge fund managers' income be deferred for up to three years.⁸³ Not surprisingly, the hedge funds believe they are "being targeted for public retribution in the same way as investment bankers, despite reports confirming that they had nothing to do with the causes of the financial crisis."⁸⁴ Hedge fund bankers are not happy about being treated like bankers. Unlike bankers, however, they do not have to stick around and take it. "About [twenty] percent of the hedge-fund community could leave the [United Kingdom] in the next two or three years. The feeling among the hedge-community is there is a better place to be."⁸⁵

Where is that better place? Asia. Places like Singapore are attracting hedge funds because "Everything in Singapore is so well or-

81. Jonathan Cheng, *Hong Kong Is Moving To Tighten Banker Pay*, WALL ST. J., Oct. 30, 2009, at C2; Anita Greil, *Swiss Regulator Sets New Pay Rules*, WALL ST. J., Nov. 12, 2009, at C2.

82. Alison Fitzgerald, *New York Eclipses London as Financial Center in Bloomberg Poll*, BLOOMBERG, Oct. 29, 2009, <http://www.bloomberg.com/apps/news?pid=20601087&sid=aEC0OYmvvcZM>.

83. Louise Armitstead, *Hedge Funds Demand Change to EU Pay Plan*, DAILY TELEGRAPH, Nov. 12, 2009.

84. *Id.*

85. Fitzgerald, *supra* note 82. (quoting David Butler of the consulting firm Kinetic Partners L.L.P.).

ganized. Everything is so efficient. Everything works.”⁸⁶ Of course, the fact that Singapore does not tax capital gains may have had something to do with its attractiveness. Its proximity to China, with the prolific savings being generated in that country probably does not hurt. Singapore faces strong competition for the savings being generated in Asia. Shanghai would like traders to think of it as the financial center of choice. So would Dubai, with its proximity to the petrodollars being generated in the Gulf. London and New York? The politicians overseeing those financial centers have other priorities.

So what does global competition mean for populist retribution against the money changers? Apparently it depends on the mobility of the money changes you are talking about. Big banks need government backing to be credible with depositors and counterparties, so the bankers at those institutions are going to have to stick around and take it. Smaller institutions, like hedge funds, are much more portable, and if Western governments attempt to impose banker-like restrictions on them, they will head elsewhere.

The exodus of the hedge funds, however, does have implications for the banks. Banks compete with hedge funds in proprietary trading (a big source of profits), and for the top employees who create those profits. Banks will be hamstrung when participating in those markets, both by the limitations on banker pay and by capital requirements. The end result may be bifurcated regulation – regulation based on populist retribution for the big banks because they depend on government backing, and regulation driven by jurisdictional competition for hedge funds. That jurisdictional competition for hedge funds may limit the activities of the big banks.

III. CONCLUSION

Barack Obama confronts a radically different financial landscape from the one that confronted Franklin Delano Roosevelt back in 1933. For Roosevelt, all that was needed to enact sweeping regulatory reform of the financial services industry was to muster the requisite political will. In fairness, that was no small matter given the opposition. Ferdinand Pecora helped to galvanize that political will by fueling the pre-existing anger at the bankers with eye-catching headlines about the obscene compensation received by those bankers and their failure to pay taxes. Anger mixed with envy is a righteous combination. Roosevelt tapped that powerful political impulse to tame the forces of capitalism with his agenda.

86. *Id.* (quoting Gary Addison, partner at Actis Capital LLP, who had worked in London and Tokyo before moving to Singapore).

For Obama, the political equation is complicated by the international integration of financial markets. The forces of financial capitalism can no longer be confined within the boundaries of a single nation, so regulation is not simply a matter of mustering the requisite political will. There is no shortage of anger against the bankers in the current environment, but it can only be deployed against financial intermediaries who cannot flee the regulatory wrath. The large banks, dependent on the government backing implicit in the “too big to fail” doctrine, have to take it. Hedge fund managers, who do not need the backing of the government to give them credibility with counterparties, are free to go where regulatory constraints impose the least cost on their preferred business model. International competition in financial services regulation now serves as a check on populist retribution, but only a partial one.